

Message Text

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ACTION EA-09

INFO OCT-01 EUR-12 IO-10 ISO-00 CIAE-00 DODE-00 PM-04 H-02

INR-07 L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15

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OPIC-03 CIEP-01 LAB-04 SIL-01 OMB-01 CEA-01 /106 W

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R 271110Z AUG 75

FM AMEMBASSY TOKYO

TO SECSTATE 2843

INFO AMEMBASSY BONN

AMEMBASSY CANBERRA

AMEMBASSY JAKARTA

AMEMBASSY LONDON

AMEMBASSY MANILA

AMEMBASSY PANUS

AMEMBASSY ROME

AMEMBASSY SEOUL

AMEMBASSY TAIPEI

AMEMBASSY WELLINGTON

USDEL MTN GENEVA

USMISSION EC BRUSSELS

USMISSION OECD PARIS UNN

LIMITED OFFICIAL USE SECTION 1 OF 3 TOKYO 12002

PASS TREASURY, CEA AND FEDERAL RESERVE

E. O. 11652: N/A

TAGS: EFIN, JA

SUBJ: CURRENT ECONOMIC SITUATION AND PROSPECTS IN JAPAN

SUMMARY: THE GENERAL VIEW IN JAPAN IS THAT THE ECONOMY HAS
HIT BOTTOM BUT RECOVERY OF DEMAND IS CONSIDERED ALL TOO SLOW.
THERE IS LITTLE RECOGNITION THAT A SHARP REBOUND IN INDUSTRIAL
PRODUCTION AND SHIPMENTS HAS ALREADY BEEN UNDER WAY FOR ALMOST
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SIX MONTHS. INDEED, PRODUCTION HAS RISEN STEADILY FROM FEB
THROUGH JULY AT A SEASONALLY ADJUSTED ANNUAL RATE OF 17 PER-
CENT AND SHIPMENTS BY 15 PERCENT SINCE JAN. THE UNWANTED
OVERHANG OF INVENTORIES HAS EASED AND MANUFACTURERS'

STOCKS OF FINISHED GOODS HAVE ALREADY BEEN REDUCED BY SOME 7.5 PERCENT. NEVERTHELESS, BUSINESS PSYCHOLOGY REMAINS GLOOMY BECAUSE OF (1) LARGE AMOUNTS OF EXCESS CAPACITY, (2) INDUSTRIAL PRODUCTION WOULD HAVE TO RISE ANOTHER 19 PERCENT TO RETURN TO THE PREVIOUS PEAK ATTAINED IN NOV 1973, (3) UNIT LABOR COSTS ARE 17 PERCENT HIGHER THAN A YEAR AGO, AND (4) CORPORATE LIQUIDITY AND PROFITS CONTINUE TO DETERIORATE. TOP GOJ ECONOMIC POLICYMAKERS ARE SHOWING DBACREASED CONCERN ABOUT THE DETERIORATING LABOR MARKET SITUATION. UNEMPLOYMENT CONTINUES TO RISE REACHING ONE MILLION (SA) IN JUNE AND THE UNEMPLOYMENT RATE ROSE TO ALMOST 1.9 PERCENT. PERHAPS OF GREATER CONCERN TO THE JAPANESE IS THE PERSISTING DETERIORATION OF NEW JOB OFFERS, AT A TIME WHEN THE PRIME MINISTER WANTS TO IMPROVE THE WELFARE OF THE ORDINARY JAPANESE FAMILY.

FOR THE YEAR AHEAD, THERE IS LITTLE REASON NOT TO EXPECT CONTINUATION OF THE RECENT RECOVERY PROCESS. THE IMPACT OF PREVIOUS STIMULATIVE MONETARY AND FISCAL POLICIES MAY YET BE FELT AND THE GOVERNMENT IS PREPARING A LARGE SUPPLEMENTAL BUDGET AND EASIER CREDIT. FROM HERE ON OUT REAL GNP SHOULD ADVANCE AT AN ANNUAL RATE OF NO LESS THAN THE 5-6 PERCENT FORCAST BY THE OECD. ON THE OTHER HAND, THE EMBASSY DOES NOT REJECT THE POSSIBILITY THAT THE PACE COULD ACCELERATE TO THE 8-1/2 PERCENT PROJECTED BY THE JERC. THE OUTCOME WILL DEPEND ON FUTURE CONSUMER SPENDING/SAVINGS HABITS AND EVENTUAL RECOVERY OF PLANT AND EQUIPMENT SPENDING WHICH ARE MAJOR UNCERTAINTIES AT THIS TIME. MOREOVER, REAL ECONOMIC GROWTH WILL BE RELATIVELY STRONGER THE MORE INFLATIONARY FORCES ARE CONTAINED. THIS OUTLOOK IS BULLISH IN COMPARISON WITH CURRENT VIEWS OF JAPANESE BUSINESS AND EVEN EPA OFFICIALS IN THEIR CONSULTATIONS WITH CEA LAST MONTH. END SUMMARY.

1. PROVISIONAL SECOND QUARTER GNP FIGURES ARE YET TO BE RELEASED. THEY MAY WELL SHOW A SMALL IMPROVEMENT

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OVER THE FIRST QUARTER IN VIEW OF THE 4 PERCENT RECOVERY IN INDUSTRIAL PRODUCTION ALREADY RECORDED (WHICH ACCOUNTS FOR 40 PERCENT OF GDP). FOR THE FIRST HALF OF 1975 GNP IS LIKELY TO BE 1-1 1/2 PERCENT (AT ANNUAL RATE) BELOW SECOND HALF OF LAST YEAR. STATISTICS ON MAJOR DEMAND COMPONENTS AVAILABLE MONTHLY ARE FAR LESS REASSURING THAT THE RECOVERY WILL BE RAPID. ONE REASON IS THAT THE CONVENTIONAL ANALYSIS IN JAPAN IS BASED ON PERCENTAGE CHANGES OVER A YEAR EARLIER. MOST STATISTICAL SERIES RECORD SUCCESSIVELY SMALLER YEAR-OVER-YEAR INCREASES IN VALUE FOR THE PAST 18 MONTHS WHICH IS INTERPRETED AS A SIGN THAT DEMAND IS STILL PLUNGING AND IS YET TO

LEVEL OFF. HOWEVER, THE SLOWDOWN IN THE INFLATION RATE ACCOUNTS FOR MUCH OF THIS SLOWER RATE OF ADVANCE. AS AN EXAMPLE, JULY DEPARTMENT STORE SALES WERE UP ONLY 9.2 PERCENT OVER A YEAR EARLIER AND THIS WAS REPORTED TO BE "THE LOWEST RATE OF INCREASE RECORDED SINCE 12/1965." AFTER SEASONAL ADJUSTMENT,, SALES ARE PICKING UP, AND IN JULY WERE 0.6 PERCENT HIGHER THAN THE SECOND QUARTER AVERAGE AND 3.1 PERCENT ABOVE THE FIRST QUARTER AVERAGE. THE FACT IS THAT CONSUMER SPENDING WAS THE MAJOR ELEMENT OF GNP STRENGTH IN THE FIRST QUARTER, BUT ANALYSIS BASED ON YEAR-OVER-YEAR CHANGES IN UNABLE TO DISTINGUISH BETWEEN RECENT DEVELOPMENTS AND PAST HAISTORY.

2. (BEGIN UNDERLINE) CONSUMER DEMAND(END UNDERLINE) REMAINS SLUGGISH ACCORDING TO SOME STATISTICAL INDICATORS. THE MONTHLY SURVEY OF HOUSEHOLD INCOME AND EXPENDITURE RECORDS A VERY HIGH AVERAGE RATE OF SAVINGS TO DISPOSABLE INCOME OF OVER 18 PERCENT THROUGH MARCH. IN MAY THERE WAS A DROP TO 16.5 PERCENT BUT THIS MAY BE DUE TO PROBLEMS IN CORRECT SEASONAL ADJUSTMENT. ANOTHER INDICATOR, THE AVERAGE AMOUNT OF CURRENTLY OUTSTANDING, ADVANCED AT A MUCH SLOWER RATE IN THE SECOND QUARTER (ONLY 8.8 PERCENT, SEASONALLY ADJUSTED AT ANNUAL RATE) IN COMPARISON WITH THE FIRST QUARTER (19.2 PERCENT) AND IS CONSIDERED STRONG EVIDENCE THAT CONSUMERS ARE NOT SPENDING BUT CONTINUING TO SAVE. ON THE OTHER HAND, THERE IS SOLID EVIDENCE THAT AUTO SALES HAVE ALREADY RECOVERED. IN THE FIRST HALF OF 1975 NEW

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R 271110Z AUG 75

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 2844

INFO AMEMBASSY BONN

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C O R R E C T E D C O P Y

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CAR REGISTRATIONS WERE ALMOST 40 PERCENT HIGHER THAN A
YEAR EARLIER. AFTER VERY ROUGH SEASONAL ADJUSTMENT,
EMBASSY CONSIDERS THE RECOVERY STARTED LAST OCT AND NEW
REGISTRATONS HAVE BEEN ON A HIGH PLATEAU THROUGH MAY.
IN JUNE THEY ROSE TO AN ANNUAL RATE OF 2.7 MILLION
(COMPARED WITH 2.9 MILLION IN PEAK YEAR 1973) BUT THIS
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MAY BE TEMPORARY AS COMPANIES MADE FLEET PURCHASES TO
HELP REDUCE EXCESS INVENTORIES AND IMPROVE CASH POSITION
OF AUTO MANUFACTUERERS. THERE IS LITTLE RECOGNITION OF
THE RECOVERY IN AUTO DEMAND THAT THAS ALREADY OCCURRED
AND IS LIKELY TO ACCELERATE. THERE IS EVEN LESS RECOG-
NITION OF THE IMPORTANCE OF THIS SECTOR OF DEMAND (14
PERCENT OF CONSUMER EXPENDITURES IN CONTRAST TO ONLY
7 PERCENT IN THE U.S.).

3. GOVERNMENT SECTOR SPENDING IS BEING ACCELERATED TO
STIMULATE ECONOMIC RECOVERY. PREVIOUS FISCAL MEASURES
(TOKYO 8033, 4121, 1412) ACCELERATED CONTTACTING OF PUB-
LIC WORKS PROJECTS FROM THE SCHEDULE ORIGINALLY ENVISAGED
IN THE BUDGET. A LARGE SUPPLEMENTAL BUDGET NOW
IN PREIARATION FOR PRESENTATION TO THE DIET IN SEPT IS
LIKELY TO PROVIDE FOR 25 PERCENT MORE FUNDS FOR PUBLIC
WORKS THAN IN THE ORIGINAL BUDGET AND 17 PERCENT MORE FOR
THE FISCAL LOAN AND INVESTMENT PROGRAM. THE ACTUAL IMPACT
OF THE FISCAL STIMULUS IS DIFFICULT TO ASSESS. GOVERN-
MENT EXPENDITURE FIGURES TO DATE TO NOT YET SHOW ANY
INCREASE. ON THE OTHER HAND PUBLIC CONSTRUTION STARTS
(SA) WHICH HAD BEEN STABLE FOR THREE QUARTERS ROSE
ABRUPTLY BY 25 PERCENT IN APRIL (LATEST MONTH FOR WHICH
DATA ARE AVAILABLE). ALL IN ALL GOVERNMENT CONTRACTING
AND SPENDING WILL BE IMPORTANT RECOVERY STIMULI AT LEAST
THROUGH YEAR END. GOVERNMENT SECTOR PURCHASES OF GOODS
AND SERVICES (NATIONAL INCOME BASIS WILL INCREASE BY
PERHAPS 18 TO 19 PERCENT OF JFY 1974 IN CONTRAST TO THE
ORIGINAL BUDGET ESTIMATE OF 14.4 PERCENT. IN ADDITION,

THE SHORTFALL IN TAX RECEIPTS AS RESULT OF BUILT-IN FISCAL STABILIZERS IS PROVIDING ADDITIONAL ECONOMIC SUPPORT. APPARENTLY THE PROSPECT OF AN ALL-TIME RECORD BUDGET DEFICIT IS NO LONGER OF OVERRIDING PUBLIC CONCERN.

4. DETERIORATING LABOR MARKET CONDITIONS ARE BEING RECOGNIZED AS A REASON FOR STRONGER FISCAL AND MONETARY MEASURES. TOTAL EMPLOYMENT IS NO LONGER SHRINKING BUT THE NUMBER OF UNEMPLOYED KEEPS RISING (TO ONE MILLION, SA, IN JUNE, UP 7.5 PERCENT FROM DEC). THE UNEMPLOYMENT RATE ALTHOUGH NOT A SENSITIVE INDICATOR AND ONE THAT UNDERSTATES THE ACTUAL SITUATION (SEE TOKYO A-41) REACHED LIMITED OFFICIAL USE
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1.89 PERCENT (SA) IN JUNE, THE HIGHEST IN 20 YEARS AND UP FROM 1.76 PERCENT IN DEC. NO DOUBT HIGH WAGES NOW BEING PAID IN JAPAN HAVE PRESSURED BUSINESS INTO USING LESS LABOR AND USING IT MORE EFFICIENTLY. OF GREATER CONCERN IN JAPAN IS THE RATIO OF JOB OFFERS TO JOB SEEKERS: IT DROPPED BELOW THE "CRITICAL" 1.0 LEVEL LAST OCT AND BY JUNE HAD FALLEN TO 0.58 (SA). THE RECESSION IMPACT IS HEAVIER ON THE MORE VULNERABLE ELEMENTS OF SOCIETY AND THERE IS CONCERN OF GROWING ECONOMIC DISPARITIES BETWEEN VARIOUS GROUPS AT A TIME WHEN GOVERNMENT PRIORITIES SEEK TO CORRECT ECONOMIC INEQUALITIES IN THE SOCIETY. THUS GOJ MUST NOW BALANCE ECONOMIC POLICIES TO MEET TWO OBJECTIVES, NAMELY EMPLOYMENT AND PRICE STABILITY. IN THE PERIOD AHEAD GREATER PRIORITY WILL PROBABLY BE GIVEN TO EMPLOYMENT SINCE INFLATION SEEMS NOW TO BE LESS OF A PROBLEM.

5. INFLATION HAS MODERATED. WHOLESALE PRICES REMAIN VIRTUALLY UNCHANGED FOR THE PAST NINE MONTHS, AND IN JUNE WERE UP ONLY 2.2 PERCENT ABOVE 6/74. CONSUMER PRICES ON THE OTHER HAND CONTINUE TO RISE IN ACCORDANCE WITH LONG-ESTABLISHED HISTORICAL TREND. THE CIP, EXCLUDING SEASONAL GOODS, ROSE AT AN ANNUAL RATE OF 8 PERCENT IN THE FIRST SIX MONTHS. TO SOME EXTENT, THIS REFLECTS THE CATCH-UP EFFECT OF PRICE INCREASES IN MEDICAL AND HEALTH CARE, RENT, HOUSING AND SIMILAR SERVICES THAT TEND TO LAG BEHIND GENERAL PRICE INCREASES. IN ADDITION, THE INEFFICIENCIES IN JAPAN'S DISTRIBUTION SYSTEM HAVE RESULTED IN LARGER PRICE INCREASES AT THE SMALL STORES THAN AT DEPARTMENT STORES AND SUPER MARKETS. THE GOVERNMENT STILL INTENDS TO RAISE THE RETAIL PRICE OF RICE AGAIN THIS FALL AND MINISTER OHIRA WILL PRESS FOR A RISE IN THE LIQUOR AND TOBACCO TAXES AND INCREASES IN PRICES OF PUBLIC SERVICES SUCH AS POSTAL SERVICE, ETC. NEVERTHELESS, THE GOAL OF "ONE-DIGIT" PRICE INCREASE BY MARCH 1976 HAS BY NO MEANS BEEN ABANDONED

AND MAY YET BE ACHIEVED.

6. INDUSTRIAL PRODUCTION AND SHIPMENTS DROPPED 21.4
AND 20.3 PERCENT, RESPECTIVELY, FROM THE PEAK IN 11/73
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TO THE CYCLICAL TROUGH EARLIER THIS YEAR. IN ABOUT
SIX MONTHS BOH PRODUCTION AND SHIPMENTS HAVE RECOVERED
ABOUT ONE QUARTER OF THOSE DECLINES. CONSUMER
GOODS INDUSTRIES (24 PERCENT OF THE TOTAL INDEX) DECLINED
LESS THAN MANUFACTURING AS A WHOLE, AND BY JUNE HAD
VIRTUALLY RECOVERD TO YEAR-AGO PRODUCTION LEVELS.
HARDEST HIT BY THE CURRENT RECESSION HAVE BEEN JAPAN'S
HEAVY INDUSTRIES. INDUSTRIAL MACHINERY PRODUCTION WAS
RELATIVELY UNAFFECTED BY T E RECESSION UNTIL 4/74 BUT
IN LESS THAN ONE YEAR OUTPUT DROPPED 23 PERCENT.
ELECTRICAL MACHINERY WAS SIMILARLY HARD HIT. THE
RECESSION IN IRON AND STEEL WAS DELAYED UNTIL
AFTER MID-74 BUT BY 5/75 PRODUCTION HAD DROPPED A
MODEST 14 PERCENT. ALL OF THESE HEAVY INDUSTRIES ARE
OPERATING WITH LARGE EXCESS CAPACITY. FOR MANUFACTURING

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ACTION EA-09

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R 271110Z AUG 75

FM AMEMBASSY TOKYO

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INFO AMEMBASSY BONN

AMEMBASSY LONDON

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PASS TREASURY, CEA AND FEDERAL RESERVE

AS A WHOLE HHE OPERATING RATE IN JUNE WAS 82 PERCENT
OF THE 1970 BASE. FOR CHEMICALS AND NON-FERROUS
METALS THE INDEX WAS EVEN LOWER AT AROUND 73 AND FOR
PULP AND PAPER AT 67. SUCH LOW LEVELS OF OPERATION
ARE AN ENTIRELY NEW EXPERIENCE FOR JAPANESE INDUSTRIALISTS.
THEY HAVE HEAVY FIXED COSTS FOR LABOR AND INTEREST
CHARGES TO BEAR WHICH HAVE CREATED SERIOUS AND LONG-
LASTING CASH FLOW AND INSOLVENCY PROBLEMS. WITH EFFECTIVE
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BANKS BORROWING RATES STILL IN THE 12-13 PERCENT RANGE,
IT IS LITTLE WONDER THAT THEY DEMAND AN END TO TIGHT MONEY
AND HIGH INTEREST RATES. THIS CASH FLOW PROBLEM, CON-
SINERABLE EXCESS CAPACITY AND PROSPECTS FOR SLOWER FUTURE
GROWTH OF THE JAPANESE ECONOMY HAVE RESULTED IN DOWNWARD
REVISIONS FOR FUTURE PLANT AND EQUIPMENT EXPENDITURE PLANS.

7. PLANT AND EQUIPMENT EXPENDITURES ARE STAGNATING
ACCORDING TO ADVANCE INDICATORS SUCH AS NEW ORDERS FOR
MACHINERY. EVEN SURVEYS OF FUTURE PLANT AND EQUIPMENT
SPENDING INCICATE DOWNWARD REVISIONS BY THE MANUFACTUR-
ING SECTOR ALTHOUGH OUTLAYS IN NONMANUFACTURING
WILL CONTINUE TO
INCREASE SOMEWHAT. EXCEPT FOR HOUSING CONSTRUCTION WHICH
CAN BE STIMULATED BY GREATER CREDIT AVAILABILITY,
ESPECIALLY FROM GOVERNMENT FINANCIAL INSTITUTIONS,
FIXED PRIVATE INVESTMENT WILL CONTRIBUTE LITTLE, IF ANY,
TO THE ECONOMIC REVIVAL IN DEMAND UNTIL SOMETIME IN 1976.

8. INVENTORY LIQUIDATION HAS PROBABLY RUN ITS COURSE.
COMPREHENSIVE STATISTICS FOR THE SECOND QUARTER (CRUDE
ESTIMATES AT THAT) WILLNOT BE AVAILABLE UNTIL THE GNP
STATISTICS ARE RELEASED. REVIVAL IN FACTORY SHIPMENTS
SUGGESTS THAT DE-STOCKING IN THE DISTRIBUTIVE CHAIN HAS
ENDED AND STOCKS ARE AT LEAST BEING MAINTAINED. INVENTOR-
IES FOR FINISHED GOODS BY MANUFACTURERS ALSO PEAKED OUT
AT THE TURN OF THE YEAR. THEREFORE, INVENTORY INVEST-
MENT WILLNO LONGER BE A DRAG ON THE ECONOMY AND MAY
CONTRIBUTE A LITTLE TOTHE STRENGTH OF THE PROSPECTIVE
RECOVERY.

9. RISING FOREIGN SALES, AS MEASURED IN THE NATIONAL

ACCOUNTS, KEPT THE DROP IN JAPAN'S REAL GNP TO LESS THAN 2 PERCENT IN 1974. BY THE FOURTH QUARTER OF LAST YEAR THE NET EXTERNAL SURPLUS WAS EQUAL TO 3.5 PERCENT OF GNP (1970 PRICES) OR HIGHER THAN THAT REACHED DURING THE PERIOD OF LARGE BALANCE OF PAYMENTS SURPLUSES IN 1971-2. AS THE TERMS OF TRADE TURNED AGAINST JAPAN AS A RESULT OF INCREASED OIL AND OTHER RAW MATERIAL PRICES, JAPAN WAS ABLE TO INCREASE THE VOLUME OF ITS EXPORTS COMMENSURATELY. THIS NOT ONLY HELPED TO MEET THE HIGHER LIMITED OFFICIAL USE
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IMPORT BILLS, BUT WAS A MAJOR STABILIZING FACTOR DURING THE CYCLICAL DECLINE IN DOMESTIC DEMAND. HOWEVER, IN FIRST HALF OF 1975 THE NET EXPORTS IN REAL TERMS PROBABLY CONTRIBUTED LITTLE TO FINAL DEMAND. THE VOLUME OF EXPORTS (QUANTUM INDEX) PEAKED IN OCT AND THERAFTER DROPPED 15 PERCENT THROUGH JUNE. THE DECLINE IN IMPORT VOLUME SET A YEAR AGO AND HAS ALSO AMOUNTED TO ABOUT 15 PERCENT. THE FIRST SIGN THAT JAPAN'S ECONOMIC RECOVERY IS HAVING AN IMPACT ON IMPORTS IS THE LARGE 9.5 (SA) INCREASE IN THE VOLUME FROM JUNE TO JULY. FOR THE PERIOD AHEAD PRICES OF IMPORTS (BOTH YEN AND DOLLAR) MAY NO LONGER DECLINE AS IN THE PAST NINE MONTHS IN VIEW OF THE PROSPECT OF HIGHER PRICES FOR OIL AND SOME FOODSTUFFS. THEREFORE, THE INCREASE IN THE DOLLAR VALUE OF IMPORTS SHOULD RISE PARI PASU WITH AN INCREASED IMPORT VOLUME. THE RECOVERY IN IMPORTS IS PROJECTED TO BE SLOWER THAN THE IMPORT DECLINE RECORDED IN THE FIRST HALF. IN FACT IMPORT VALUE IS NOT EXPECTED TO SURPASS THE FIRST HALF 1975 UNTIL A YEAR FATER. EXPORTS IN JULY ALSO REVIVED BOTH IN VALUE AND IN VOLUME. HOWEVER, IN VIEW OF DELAYED ECONOMIC RECOVERY IN MOST OF JAPAN'S EXPORT MARKETS, A SLOW RECOVERY IN EXPORTS IS ANTICIPATED. AS IS SHOWN IN THE TABLE BELOW, THE TRADE SURPLUS MAY WELL BE SOMEWHAT SMALLER IN THE NEXT TWO HALF-YEAR PERIODS AND THE SURPLUS ON CURRENT ACCOUNT MAY SHRINK FROM 1.1 BIL IN THE FIRST HALF OF 1975 TO ABOUT ZERO.

JAPAN'S TRADE AND CURRENT ACCOUNT 1975-1976

(BILLION DOLLARS)

	1975		1976
	FIRST HALF	LAST HALF	FIRST HALF
EXPORTS (SA)	28.3	26.5	27.9
IMPORTS (SA)	-24.2	-22.8	-24.9
TRADE BALANCE	4.1	3.7	3.0
INVISIBLES	-3.0	-2.9	-3.2
CURRENT ACCOUNT	1.1	0.9	-0.2

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